

Identity fraud



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Simple yet sophisticated

In the past, the typical real estate fraud or forgery case involved a homeowner who obtained a mortgage loan against property that the borrower owned but where an impostor executed the mortgage as co-owner or consenting spouse. Often, the culprit was caught. Frequently the lawyer acting on the loan did not ask for or obtain photo identification of both parties to be satisfied as to the identities of the signing parties.

The newest brand of fraud in real estate transactions is far more outrageous and bold, seems highly organized and strikes at people totally unrelated to the fraudsters. It is sophisticated and yet simple and it is not easily detected, if detectable at all. Even the most diligent lawyer can be easily duped. We are all vulnerable to it. We probably can't stop it. It involves identity theft, fraudulent documents, impostors and forgery.

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The fraud operates with some variation as follows.

Mr. and Mrs. Smith bought a new home in an upscale subdivision in Newmarket for \$500,000 in the summer of 2000. They gave a mortgage to the bank for \$350,000. Their property is registered in the Land Titles system. They live in the property.

Their home has been targeted by the fraudster, perhaps with the help of someone in a real estate broker's office who knows when properties get bought and sold. The fraudster, presumably with some assistance from a well-trained law clerk or other paralegal, does the following.

Step 1: "Buying" a property

First, the fraudster prepares, and then registers a Deed from Mr. and Mrs. Smith to Mr. X and declares that the purchase price is \$550,000. He pays Land Transfer Tax on \$550,000. Mr. X is now the registered owner of the property. He has had Mr. and Mrs. Smith's signatures forged, he has signed a Land Transfer Tax affidavit which appears to have been sworn, he names a law firm as preparer of the Transfer and he names a new law firm as the lawyers who prepared the Land Transfer Tax affidavit and who will appear to have acted for him on the purchase.

A week later, he prepares a discharge of mortgage from the Bank using phoney names as signing officers and naming either the Bank's mortgage processing centre or a law firm as the preparer of the document. He may even include the name or initials of a lawyer in the law firm on the document. He registers the discharge.

Mr. X is now the registered owner of the property free and clear of encumbrances. (In some cases, the fraudster uses his own name as transferee. In other cases, the transferee is a fictitious name or the name of some other innocent person whose identity has been stolen.)

Step 2: Accessing mortgage funds

The fraudster then goes to a mortgage broker or a bank and applies for a loan of \$275,000 against this property. The fraudster will indicate that he buys and sells real estate frequently, buys for cash and then obtains his financing later and is willing to pay a sizeable mortgage brokerage or placement fee if a mortgage can be arranged easily and quickly.

The broker finds a lender who is more than happy to lend on 50 per cent of the value of this relatively new house. Mr. X may also tell the broker or lender that the property has just been rented out to tenants and he doesn't want the tenants disturbed by someone doing an interior inspection or appraisal of the property. Given the loan to value ratio, the lender or broker will decide that a drive-by appraisal is sufficient, or a property database valuation is done instead. Forged documents, including income references from an employer, are provided or alternatively Mr. X indicates that he is self-employed so that there is no employment record. Any sense of an inflexible lender will move the fraudster to some other lender.

The lender appoints the usual lawyer it uses for these types of deals to do the legal work on the mortgage loan. The lender sends out its typical commitment and letter of instructions. The fraudster, who is now the borrower, indicates that he wants the deal done quickly and is most flexible about who does the legal work for the lender. To expedite the deal, he is content that any lawyer the lender wants can do the deal.

Step 3: Working with the duped lawyer

The lawyer receives the instructions and searches title. The lawyer discovers that Mr. X is the registered owner, free and clear of encumbrances and that he bought the property a few days or weeks ago. If the Land Titles system has not certified the deed to Mr. X and the mortgage discharge yet, the lawyer will review them to see that they are satisfactory. They will be flawless documents. He searches realty taxes and discovers that the taxes are up to date but of course the tax certificate indicates Mr. and Mrs. Smith as owner. That is simply explained since Mr. X recently bought the property and the records at the tax office have not been changed. The lawyer searches executions and they too are clear.

The lawyer may ask the borrower if he has a survey of the property. Most likely he does not. The lawyer might think about calling the lawyer who appears to have acted on Mr. X's purchase recently, but the borrower will instruct him not to do so, explaining he and the lawyer had a falling out or he doesn't want his purchase lawyer contacted.

It may well be that the lender will waive the survey since this is a relatively new house and what kind of problems could there be in any event? There can't be much risk given the loan-to-value ratio. The lawyer may be instructed to obtain title insurance to insure over the absence of a survey or the lender may require title insurance for the loan in any event. Some title insurers don't require a survey on whole lots on a plan of subdivision.

The lawyer prepares the usual mortgage documents. Of course, Mr. X is anxious to get the deal done and has already pressed the broker and the lawyer to expedite matters because he "needs the money for another deal" or "is going out of town."

The borrower attends at the lawyer's office to sign documents. The lawyer asks for and sees his driver's licence or other photo identification as proof of identity. Sure enough, there is Mr. X's picture on the driver's licence. The address on the driver's licence is not the property address, which makes sense; the borrower has indicated that it is an investment property. The birth date on the driver's licence matches the birth date of Mr. X on his deed.

Mr. X may also advise the lawyer that he deals frequently in real estate and there may be more deals to follow. Mr. X receives his \$275,000 loan, from which the brokerage fee is paid to the broker, the lawyer deducts his fees from the advance, and Mr. X receives his advance. Mr. X then deposits \$20,000 into a bank account to cover the post-dated cheques that he has written to cover the mortgage payments that will be made on this mortgage for the

next few months. The balance of the funds is given directly to Mr. X, or is directed by Mr. X to a foreign exchange office, converted into U.S. dollars and moved offshore.

This scenario, with some variations, has been discovered in the greater Toronto area on numerous occasions. In one situation, Mr. X did this six times over a five-month period on different properties. After about six or seven months, the money in the bank account ran out and the new mortgages were in default. Mr. X had stolen \$1.5 million. In another case, \$850,000 was stolen on two mortgages over three months. In yet another case, \$700,000 was stolen on two mortgages in two weeks.

Step 4: The plan unravels

In the meantime, in each case, a lawyer has certified to the new lender that it has a first mortgage on the property. The bank, whose mortgage has been improperly discharged from title, is still receiving payments from Mr. and Mrs. Smith who live in the house but who do not have registered title. When the new mortgage

goes into default, and demand is made on the occupants, everyone starts scratching their heads wondering who has what and who is to blame.

There is little or nothing that would make this loan transaction suspicious in the ordinary course. Presumably, the lender has already checked out the borrower. Even then, Mr. X is the registered owner of the property under Land Titles; he produced acceptable photo identification. What circumstances would there have to be for the lawyer to blow the whistle on a straight-forward residential mortgage loan?

Unfortunately, real estate lawyers seem to be necessary pawns in the fraud because they act for the new lenders and they certify title and the validity of the mortgages that they register. The legal issues that arise not only in this type of fraud but in any fraud, forgery and impostor cases, including such questions as who is entitled to relief and what is the role of the lawyer, are complicated.

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Can we really rely on the Land Titles Register?

What may be more shocking than the brazen conduct of the fraudsters is the damage done by the fraud and how the authorities react to it.

The lawyer's first reaction is probably that these instances of identity fraud are a case for the Land Titles Assurance Fund since, of course, Land Titles guarantees titles and guarantees against fraud. Surely, the new lender and the lawyer were entitled to rely on the title register to take a mortgage from Mr. X. Surely Land Titles has responsibility for registering and vouching for the deed to Mr. X and the bank's mortgage discharge.

Most lawyers would, without hesitation, come to the defence of a lawyer who clearly followed accepted conveyancing practice. The lawyer relied on the Land Titles system that guarantees title to the registered owner and received photo identification from the borrower.

Unfortunately, the Land Titles system does not do that or if it does, it does so in a very limited way. The Land Titles system, and all rights arising under it, depend on the statutory provisions contained in the *Land Titles Act*. The two major principles of Land Titles that arise from the Act, the mirror principle (the title

register reflects ownership) and the curtain principle (one does not have to look behind the title of the person shown as registered owner) do not operate without qualification when there is fraud. Specifically, a forged document is null and void even in Land Titles and, but for certain provisions in the *Land Titles Act*, it has no effect. It is for this reason alone that lawyers giving opinions on the validity and enforceability of documents must consider confirming the identity of signing parties.

The ability of lawyers to rely on the title register in Land Titles has its theoretical roots in the interpretation of the *Land Titles Act* and the application of one of two doctrines: immediate indefeasibility and deferred indefeasibility of title. In fact, and as discussed later, the provisions of the *Land Titles Act* and not the application of these theories govern.

Immediate indefeasibility

The doctrine of immediate indefeasibility would find that once Mr. X was registered as owner of the land, he is, in fact, the owner, even if he became the registered owner fraudulently. That does not appear to be the law in Ontario and nothing in the *Land Titles Act* supports that conclusion. The person who has fraudulently been registered as owner does not acquire good title. The title register does not guarantee good title to the fraudster simply by virtue of being named the owner on title.

Deferred indefeasibility

However, with deferred indefeasibility, while Mr. X does not get title simply by being the registered owner, anyone who innocently deals with him as the registered owner, regardless of how Mr. X became the registered owner, and without actual notice of the fraud, will acquire an interest in the land. It is the second person relying on the registered title and not the fraudulent titled owner that gets title. An indefeasible title is deferred to the innocent person dealing with the person registered as owner.

In our case, Mr. X never gets title to the property just because he is registered as owner. The mirror principle and the right to rely on the title register breaks down.

However, the new lender can obtain a valid interest in land and can rely on the mirror principle and the curtain principle to obtain a valid interest in land since the lender relies on deferred indefeasibility.

This principle is embodied in the *Land Titles Act* which provides in Section 45 that only the first registered owner in Land Titles is declared the owner of property. Thereafter, and according to Sections 66, 68, 86, 87 and 93, only the registered owner can

transfer or charge land. If Mr. X is noted on title as the registered owner by virtue of a forged transfer, the transfer is invalid since it was not signed by the registered owner. But if Mr. X, as registered owner, transfers or charges the land, Mr. X will, according to the Act, transfer or charge the land to the innocent purchaser or chargee.

A good example of this principle is set out in the recently reported *Durrani v. Augier* (50 O.R.(3d) 353) case where an innocent bank's mortgage was valid even though the borrower was held ultimately not to be the owner of the property.

However, there is a catch to this doctrine of deferred indefeasibility embodied in the above sections of the *Land Titles Act* which explains why impostors and forgers, signing for registered owners, can never create valid interests in land for subsequent holders, unless they have previously put title into their own real names.

The *Land Titles Act* specifies that only the person registered as owner can charge land. Thus, the new mortgage is valid according to the Act and the principle of deferred indefeasibility applies only if the person who is the registered owner has signed the mortgage. If, after the initial step of the fraud, the person who is registered on title does not exist or if the registered owner is a made-up name, or if the fraudster registered title in the name of another person and then used phoney identification to pose as that person, the mortgage is invalid and deferred indefeasibility does not apply. The Act requires that the registered owner transfers or charges land, and that the registered owner must be the real person who deals with the property in his or her own name.

Similarly, if there was a real Mr. X, but the person who attended at the lawyer's office was an impostor for Mr. X, then the mortgage is invalid according to the doctrine of deferred indefeasibility and the *Land Titles Act* because only the registered owner has the right to charge the property. This is the common problem when Mr. X appears with his impostor spouse to sign a mortgage or when, in the case of identity theft, the fraudster poses as some other person with forged or fraudulent identification. The real person did not charge the property; the lender gets no interest in land.

If, however, the real Mr. X took title and signed the documentation, then the new mortgage would qualify for deferred indefeasibility (even though it was a forgery that got title to Mr. X in the first place). The new mortgage is valid *vis a vis* the fraudulently discharged bank mortgage. As for the owners who are no longer registered as owners, they are entitled, presumably, to be reregistered as owners but now they are subject to the mortgage that they had nothing to do with, and their mortgage to the bank, on which they are still liable presumably on the covenant, is not registered on title.

What about the Land Titles Assurance Fund?

Many lawyers would react to identity frauds by looking for relief from the Land Titles Assurance Fund. The Land Titles Assurance Fund is a creation of the *Land Titles Act*; it is not an insurance company and it is not title insurance. An application to the Fund can only be made where a person has been “wrongfully deprived of land or of some estate or interest in land through fraud.”

The threshold question, however, is whether the applicant had an interest in land that was lost through fraud. Since deferred indefeasibility operates only where one deals with the true registered owner, a mortgage signed by an impostor for the then-registered owner is invalid and the lender never receives an interest in land. Since the lender has lost no interest in land (since he never had one), the lender does not qualify for compensation under the Act.

This is another reason why obtaining identification of the parties is so critical. To rely on the Land Titles system, one must be certain they are dealing with the registered owner. It is the reason why in all of the impostor cases, the defrauded lender gets no compensation from the Fund. The Fund has jurisdiction only

where one had an interest that has been lost. With impostor fraud, a lender never had a mortgage on the land. It did not lose an interest in land. It simply lost its money by lending to a person who did not own the property.

Even if the party had an interest in land that was lost, the *Land Titles Act* does not make compensation easy. The fund is an assurer of last resort. To qualify for compensation, the applicant must first attempt to recover from the wrongdoer or from any other sources of compensation as may be available. Moreover, the Fund cannot compensate where the claimant is seen to have substantially contributed to its own loss.

In simple terms, one can rely on the Land Titles register only when one is dealing with the registered owner and not with an impostor. As for the government standing behind the system and guaranteeing good title, it is an over simplification of the basis on which the Land Titles system works and a misunderstanding of the *Land Titles Act*.

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identity/ forgery fraud

What can you, as a real estate practitioner, do to prevent the fraud? If you act reasonably and follow the acceptable standard of searching title, relying on the title register and obtaining identification, what else could or should you be doing?

Arm yourself with knowledge. Understand and recognize the conduct characteristics that appear to be common in many of these frauds. Ask questions. Understand and believe that you can be targeted by a fraudster.

What makes real estate transactions vulnerable?

The fraudsters in identity/forgery scams understand the real estate business and the way lawyers, mortgage brokers and lenders work. They know that:

- Lenders will happily lend on 50 per cent of value or significantly more on an insured loan.
- Brokers will happily find mortgage money on this basis.
- Lenders will probably waive detailed appraisals.
- Lawyers will rely on the Land Titles system to assume that there is good title.
- Lawyers ask for photo identification.
- Everyone is prepared to expedite transactions where premium fees are paid.
- Everyone is prepared to expedite transactions where the client promises more deals in the future.

The warning signs of frauds

Typically the client is a borrower who has recently purchased the property on an all-cash basis and is now borrowing against the property. Some key characteristics for which you should be on the lookout include the following:

- The borrower has the deed but no other purchase documents. S/he has no survey, although in one recent identity fraud, the fraudster even had a survey.
- The borrower is in a very big hurry. The turn-around time on the deal is one to three days.
- The lawyer who acted on the “purchase” is not acting on the loan or acting for your borrower.
- The borrower instructs you not to contact the lawyer who acted on his recent “purchase.”
- The borrower may not have placed fire insurance on his house.
- The mortgage brokerage fee seems generous on what should be a simple residential loan.
- Part of the mortgage advance is directed to third parties, including foreign exchange companies or off-shore recipients.
- The borrower indicates that he is quite active in real estate investing and does deals like this frequently; more deals may come your way.
- The utility companies have no knowledge of the borrower owning the property. By way of contrast with the realty tax department, utility companies should have been given notice before closing that the borrower was purchasing and should have set up new accounts in the borrower’s name.